OGC 81-03428
27 April 1981

MEMORANDUM FOR: Chief, Benefits & Services Division, OPPP&M

STAT FROM : [redacted]
Office of General Counsel

SUBJECT : New IRS Regulations Concerning Voluntary Employee's Beneficiary Associations, Treasury Regulations § 1.501(c)((9); Applicability to GEHA, EAA, EAF, and PSAS

1. By routing and record sheet dated 7 April 1981, you have asked this office to examine regulations issued by the Treasury Department under Section 501(c)(9) of the Internal Revenue Code. These regulations became effective 1 January 1981. The new regulations, beginning with Treas. Regs. § 1.501(c)(9)-1, are referred to hereinafter as the "(c)(9) Regulations."

The New Regulations

2. The (c)(9) Regulations limit exemption from taxation to certain qualifying organizations under Section 501 of the Internal Revenue Code (Code). Subsection (a) of Section 501 states that certain organizations shall be exempt from taxation: "An organization described in subsection (c) or (d) or Section 401(a) shall be exempt from taxation under this subtitle...." Paragraph (9) of subsection (c) states:

> "Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual."

Code Section 501(c)(9), 26 U.S.C. § 501(c)(9), as amended.

The (c)(9) Regulations are an attempt to "clarify" the requirements for qualification under the somewhat ambiguous terms of the Code.

3. The principal requirements addressed in the (c)(9) Regulations are as follows:

(a) Control by employees. The Code does not speak to the issue of employee control at all. The (c)(9) Regulations, however, require that a qualifying voluntary employees' beneficiary association be "controlled by its membership, or by independent trustees, or by trustees or other fiduciaries at least some of whom are designated by, or on behalf of, the membership." See "Supplementary Information," 46 FR 1719 (7 January 1981). As the introductory notes in the (c)(9) Regulations state, the requirement of employee control is intended to insure that the qualifying association is run by and for employees, rather than by an employer, or by a separate corporate organization.

(b) Disproportionate benefits. Once again, the Code is silent on this requirement. The drafters of the (c)(9) Regulations go out of their way, in their introductory remarks, to attempt to justify this new requirement. Essentially, the "disproportionate benefits" requirement disqualifies employees' associations which provide for "discriminatory" eligibility, either for membership or for a particular benefit. The intent is to prohibit special payments to officers, shareholders, or highly compensated employees, especially where the payments are made by the employer. A telephone call to the IRS elicited the opinion that this intent is the single most important objective behind the new regulations. (This is consistent with a number of "reform" provisions in the Code itself and in other regulations intended to prohibit "back door" deferred compensation plans for highly paid executives.) The (c)(9) Regulations do not, however, prohibit all differential benefits among employees, in particular when those benefits are a uniform percentage of compensation, or where the benefits are proportional to the employees' contributions to the plan. Finally, a plan will not be deemed to be discriminatory where a payment during any particular year is high because of an adverse experience suffered by the recipient in that year.

(c) Membership "bonds." An important provision in the (c)(9) Regulations concerns employees' associations composed of individuals who have different employers. The aim of these restrictions appears to be to prevent the Code exemption from being used to create a tax exempt device for offering insurance to unrelated individuals scattered throughout the country, or to "transient" members with little or no permanent connection to a "paper" association. Such a device might circumvent the provisions of the Code that prescribe the income tax treatment of insurance companies, and that prohibit organizations such as national trade associations (which are exempt from taxation under Code Section 501(c)(6)) from operating an "unrelated trade or business." The (c)(9) Regulations, in such cases, require that membership in a "multiple employer" association be limited to

individuals engaged in the same line of business in the same geographic locale.

(d) Definition of "other benefits." A key policy behind Code Section 501(c)(9) is to encourage organizations which provide health-related insurance and other payments to wage employees. The (c)(9) Regulations enforce this policy by prohibiting such organizations from being used to provide pension or retirement income benefits except under limited circumstances. But the new regulations take a broad view of what benefits can be considered health-related. For example, under the new regulations the term "other benefits" includes "subsidizing recreational activities such as athletic leagues," and the provision of child care facilities. Treas. Regs. § 1.501(c)(9)-3(e). These same provisions of the (c)(9) Regulations also permit a qualifying association to provide such benefits as educational training courses, "because they [the courses] protect against the contingency that interrupts earning power." Ibid. As broad as this definition of "other benefits" is, some benefits are beyond the pale. Examples of disqualifying benefits include: "the provision of savings facilities for members"; "any benefit that is similar to a pension or annuity payable at the time of mandatory or voluntary requirement"; or "a benefit that is similar to the benefit provided under a stock bonus or profit sharing plan." Ibid.

Summary of New Regulations

4. The (c)(9) Regulations on their face do not appear to pose any grave threat to what might be called "bona fide" voluntary associations of employees. It is not accurate to say, as does the memorandum dated 2 March 1981 from the American Society of the Association Executives, that "the Treasury makes it clear that a national field of membership will not satisfy the requirement..." and that such associations must be composed of participants "sharing a common employment and geographic bond." (emphasis added). According to the (c)(9) Regulations, voluntary associations will qualify so long as they have a single employer, no matter where the employees may reside. The "geographic bond" requirement is only required where there are multiple employers involved in a single association-related trust.

Application to Agency Associations

5. You have asked for our opinion as to the impact of these new regulations on certain of the Agency's employee associations: Government Employees Health Association (GEHA); Employee Activity Association (EAA), Educational Assistance Fund (EAF) and Public Service Assistance Society (PSAS). Because you are much more familiar with the detail of these organizations,

other consequences may occur to you, and we can discuss those at your convenience. However, based upon my current understanding, only GEHA and certain functions of EAA qualify under the new regulations. For those two organizations, several suggestions might be made:

(a) GEHA should not form an association with other government health associations. Were GEHA to form an association with associations composed of employees of different agencies, the association might be deemed a "multiple employer" association. As such, a common geographic bond, as well as a common business, could be required of employees. Since employees of the CIA are frequently not connected geographically, the new regulations might disqualify GEHA under those conditions. One potential area of difficulty--membership in GEHA by non-CIA employees--appears to be of no immediate concern. According to informal advice by the IRS, elicited by telephone on Monday, 20 April 1981, GEHA would not be disqualified by virtue of the fact that membership is open to "civilian and military details to the Central Intelligence Agency," as well as to "staff employees." GEHA By-Laws (as approved 17 January 1956), art. II, sec. 1. According to the IRS, as long as the employment of such "detailed" employees at the Agency (if not by the Agency) is not "transitory" (that is, for only a few days or weeks), the provision in the By-Laws should not cause GEHA to be disqualified.

(b) The (c)(9) Regulations require steps long since taken by most Agency organizations including GEHA: control of those organizations by the membership. The holding of annual meetings for GEHA would clearly indicate sufficient membership control to qualify under the (c)(9) Regulations. In any event, the Agency itself plays little part in controlling the organization, and therefore GEHA governance appears to be within the spirit as well as letter of the (c)(9) Regulations.

(c) EAA acts in part as an association encouraging participation in athletic activities. As such, its activities fall within the broad definition of "other benefits" specified in the (c)(9) Regulations. In addition, however, EAA runs a store selling merchandise to Agency employees at headquarters, and carries on other non-health related activities. These activities do not fall within the list of permissible "other benefits" set forth in the (c)(9) Regulations, and would therefore preclude qualification of EAA as an exempt organization under Code Section 501(c)(9).

(d) From the face of their by-laws, neither EAF nor PSAS appear to qualify as exempt organizations under Code Section 501 (c)(9), and therefore, the impact of the (c)(9) Regulations on

these organizations is not an issue. This conclusion is supported in correspondence from IRS, copies of which were sent to me on 17 April 1981. In said correspondence, EAF is qualified as an exempt organization under Code Section 501(c)(3). PSAS also apparently received a similar qualification under Code Section 501(c)(3).

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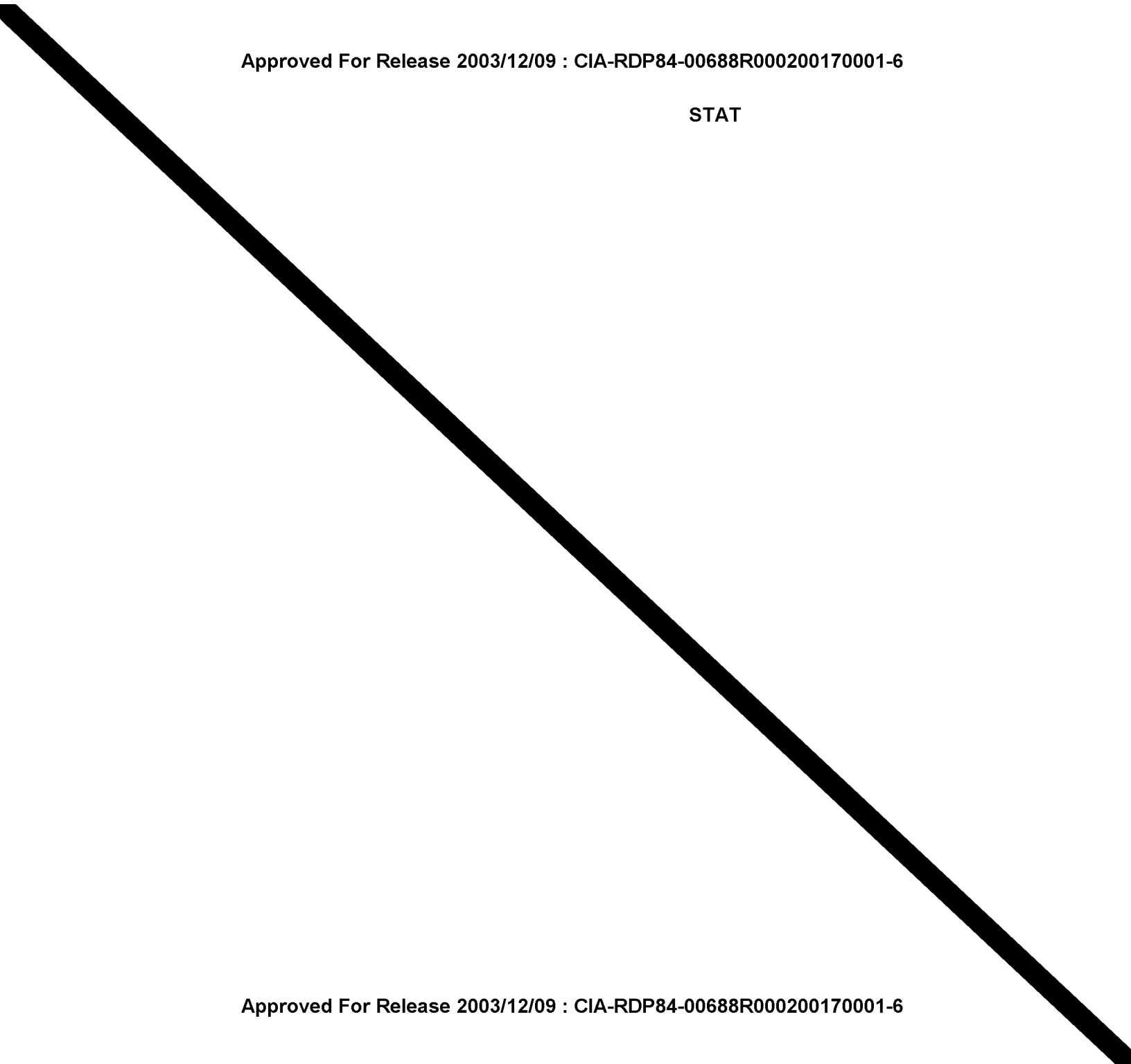

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REMARKS

Ben,

Attached is OGC response to our inquiry regarding impact of new Internal Revenue Service regulations pertaining to organizations exempt under Section 501 (c)(9).

Looks like we're in good shape - We wrote a good opinion!

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